PROPORTIONALITY IN BANK REGULATION

David T Llewellyn
Loughborough University and
Chair, Banking Stakeholder Group

Presentation at SUERF/Ernst & Young conference
3rd December, 2015
London

STRUCTURE OF THE REPORT

(1) Analytical framework

* scope of the PoP
* importance of proportionality
* legal and economic perspectives
* potential for non-proportionality

(2) Six case studies

* supervisory reporting
* liquidity
* external models
* Governance related to risk models
* Leverage ratio
* corporate governance

(3) Costs and Implications for stakeholders

(4) Recommendations

* high level
* detailed in case studies

OPENING PERSPECTIVES

- BSG certainly not antagonistic to regulation
- BSG recognises that big changes were needed in the post-crisis era
- BSG fully recognises agencies' commitment to proportionality
- Constructive contribution to important and topical debate:
  - perspectives of different stakeholders

OBSERVATION

- Complex concept: The *Five Pillars of Proportionality*
- Complexity
- Cumulative
- Differentiation

MANDATE OF PROPORTIONALITY

Regulatory authorities required to be proportionate in regulation:

- Not exceed limits of what is appropriate and necessary to attain the objectives
- When there is a choice recourse must be had to the least onerous
- Disadvantages caused must not be disproportionate to the aims pursued

WHY PROPORTIONALITY IS IMPORTANT

- Costs become excessive and avoidable
- Unwarranted change in business models
- Management role usurped
- Arbitrage within the system
- Compromise competition
- Burden on small firms: entry barriers
- Wider costs on the economy

POTENTIAL FOR DISPROPORTIONALITY

- Regulation viewed as a free good
- Symbiotic relationship
- Not recognise a trade-off
- Regulatory pendulum
- Excess harmonisation
- Duplication
- Gold-plating

THE FIVE PILLARS OF PROPORTIONALITY

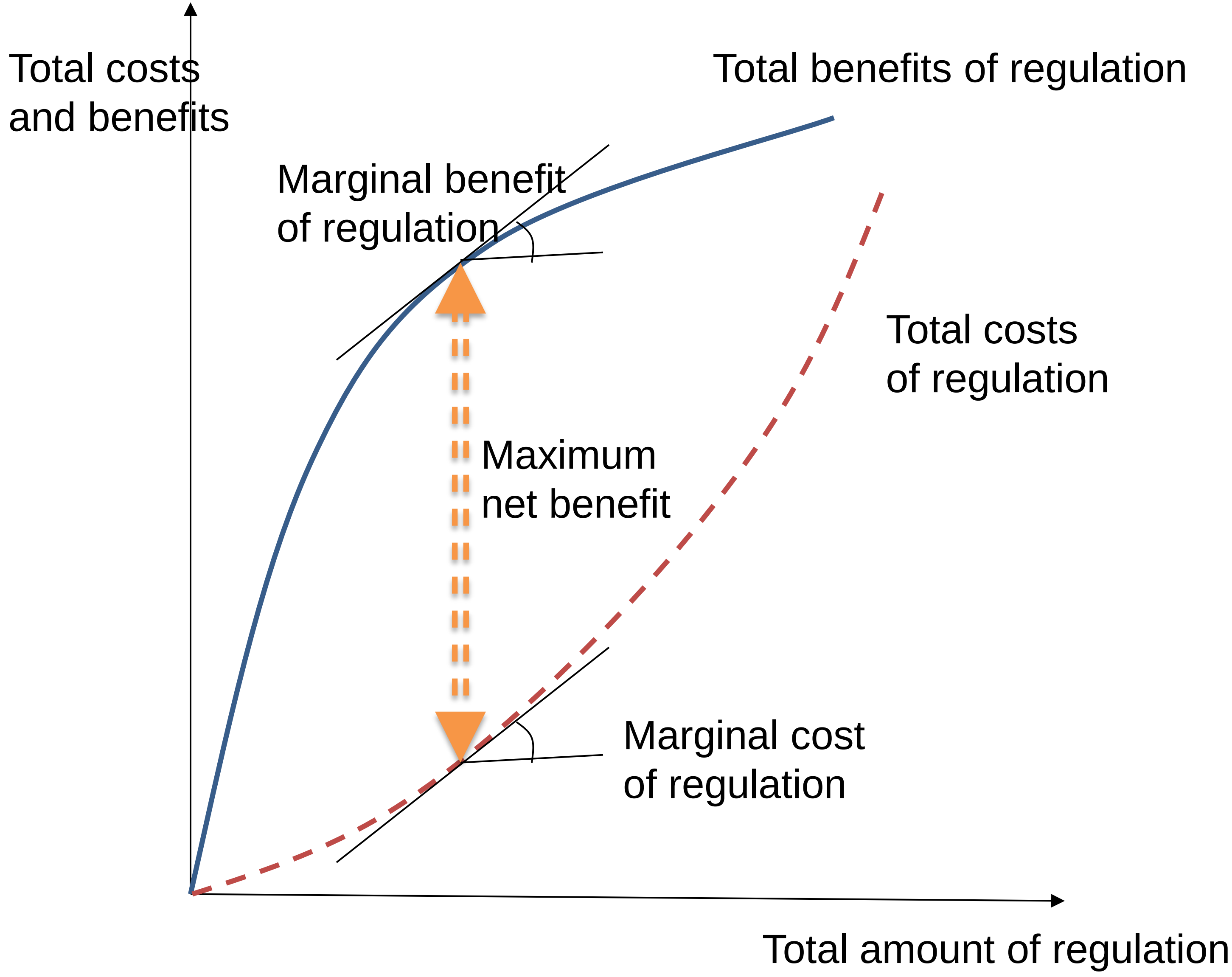
(1) Objectives: Cost Benefit Analysis

(2) Totality of regulation: diminishing returns

(3) Excess complexity

(4) Differentiations

(5) Materiality


Total costs
and benefits
Total benefits of regulation
Marginal benefit
of regulation
Total costs
of regulation
Maximum
net benefit
Marginal cost
of regulation
Total amount of regulation

EXCESS COMPLEXITY

- Costs of compliance
- Small firms
- Entry barriers
- Compliance may become superficial
- Costs of information collection and processing
- Regulatory arbitrage
- Opacity
- Difficult manage arbitrage

COMPLEXITY v. SIMPLICITY

“The more complex the environment, the greater the perils of complex control. …..because complexity generates uncertainty, not risk, it requires a regulatory response grounded in simplicity, not complexity.”

Haldane and Madouras (2012)

RECOMMENDATIONS

- Harmonised concept of proportionality
- Flexible application
- High Level Task Force
- Semi-autonomous Proportionality Review Groups within regulatory/supervisory agencies
- Regular independent reviews of proportionality and complexity
- Consideration of totality of regulation
- Review of supervisory reporting requirements
- Competitive neutrality and entry barriers
- Apply CBA at all stages

BSG REPORT

Proportionality in Bank Regulation

Report will soon become available at:

www.eba.europa.eu/bsg.